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TREASURY FOR OASIA/INL
COMMERCE FOR 4331/MAC/WH/MCAMERON
DEPT PASS TO USTR

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SUBJECT: Peru's Investment Climate Statement 2006

REF: 05 State 201904

¶1. The following is Post's submission of Peru's 2006 Investment Climate Statement, as requested in reftel.

Openness to Foreign Investment

¶2. The Peruvian government seeks to attract investment -- both foreign and domestic -- in nearly all sectors of the economy. In December 2005, Peru concluded negotiations of a free trade agreement with the United States, which could be in force by January 2007. A free trade agreement will enable Peru to attract additional investment by reducing barriers to trade, establishing proper customs procedures and improving the dispute settlement process.

¶3. During the early 1990s, the Peruvian government promoted economic stabilization and liberalization policies through the lowering trade barriers, the lifting restrictions on capital flows and the opening the economy to foreign investors. Peru experienced marked growth in foreign investment from 1993-1998. Economic reform and privatization slowed in the late 1990s however, which led to a discernible drop in direct and indirect foreign investment flows. Investment remained stagnant following the collapse of President Alberto Fujimori's government in November 2000, and through the period of an interim government and the election of President Alejandro Toledo in 2001.

¶4. During his tenure, President Toledo has implemented several pro-investment policies. In April 2002, the government established ProInversion, building on the foundation of COPRI, the privatization agency created in ¶1991. The new agency seeks to be a "one-stop shop" for current and potential investors. A difficult political climate and controversial actions by the judiciary, some regulatory agencies and Congress, however, led to the indefinite postponement of some major planned privatizations in mid-2002. However, since 2004, ProInversion has successfully completed both concessions and privatizations of state-owned enterprise and natural resources. In 2004, Las Bambas, a gold and mining operation, was concessioned to Xstrata TLC, a Swiss company, for $122 million. In 2005, Bayovar, a state-owned phosphate plant, was concessioned to a Brazilian company for more than $300 million. Most recently, ProInversion granted British-owned Rio Tinto a concession for the La Granja copper mine for $22 million. Additionally, in 2004-2005, the Ministry of Mines and Energy granted 15 concessions to foreign oil exploration companies, including three U.S. companies, along the northern coast and in the jungle.

¶5. In addition to the 1993 Constitution (enacted January 1, 1994), major laws concerning foreign direct investment in Peru include the Foreign Investment Promotion Law (Legislative Decree (DL) 662 of September 1991) and the Framework Law for Private Investment Growth (DL 757 of November 1991). The two 1991 laws were implemented by Supreme Decree 162-92-EF (October 1992). Two other important laws are the Private Investment in State-Owned Enterprises Promotion Law (DL 674) and the Private Investment in Public Services Infrastructure Promotion Law (DL 758). Under Article 63 of the Constitution, "national and foreign investment are subject to the same terms" and

are permitted in almost all economic sectors.

¶6. The 1993 Constitution guarantees national treatment for foreign investors. The Peruvian government does not screen foreign direct investment nor does it require foreign investors to register their investments. Foreign investment does not require prior approval, except in banking (and domestic investment as well, for regulatory reasons) and defense-related industries. Foreign investors are advised to register with ProInversion to obtain the guarantee that they will be able to repatriate capital, profits, and royalties. Foreigners are legally forbidden from owning majority interest in radio and television stations in Peru; nevertheless, foreigners have in practice owned controlling interests in such companies. In addition, under the Constitution, foreign interests cannot "acquire or possess under any title, mines, lands, forests, waters, or fuel or energy sources" within 50 kilometers of Peru's international borders. However, foreigners can obtain concessions and rights within the restricted areas with the authorization of a supreme resolution approved by the Cabinet. Such authorization requires a favorable opinion from the Joint Command of the Armed Forces. All investors -- domestic and foreign -- need prior approval before investing in weapons manufacturing industries.

¶7. In 1991, the Peruvian government began an extensive privatization program, encouraging foreign investors to participate. From 1991 through September 2005, privatization revenues totaled $9.4 billion, of which foreign investors were responsible for the vast majority. Over three quarters of these transactions took place in the 1994-1997 period. Through September 2005, privatization and concessions proceeds totaled $35.1 million, and generated investment commitments of $1.3 billion. The Toledo government committed to a broad program of some $3 billion in further privatizations and concessions over its five year-term, but faced strong popular and political opposition by mid-2002. The government has made only limited progress on privatizations since then, and prospects for future direct privatizations are not encouraging. The government has consequently shifted to a strategy of promoting multi-year concessions as a means of attracting investment into major projects.

¶8. In June 2004, the Congress passed a law to exclude the state-owned oil company PetroPeru from privatization and authorized PetroPeru to conduct exploration and production activities. This modified the government's policy since the early 1990s, when it sold all of PetroPeru's exploration and production units and a major oil refinery. Under this new law, the government still has an option of granting concessions on remaining PetroPeru assets, including one pipeline and several refineries. In December 2005, PetroPeru introduced a bill in the Congress to resume exploration and production activities and to be freed from contracting approval by CONSUCODE, the state contracting agency. The bill has passed the Economic Commission and is still pending debate by the Plenary. It is not expected to pass.

¶9. Under the Constitution, foreign investors have the same rights as national investors to benefit from any investment incentives, such as tax exemptions.

Conversion and Transfer Policies

¶10. Under Article 64 of the 1993 Constitution, the Peruvian government guarantees the freedom to hold and dispose of foreign currency; hence, there are no foreign exchange controls in Peru. All restrictions on remittances of profits, dividends, royalties, and capital have been eliminated, although foreign investors are advised to register their investments with ProInversion (as noted above) to ensure these guarantees. Exporters and importers are not required to channel foreign exchange transactions through the Central Reserve Bank of Peru and can conduct transactions freely on the open market. Anyone may open and maintain foreign currency accounts in Peruvian commercial banks. U.S. firms have reported no problems or delays in transferring funds or remitting capital, earnings, loan repayments or lease payments since Peru's economic reforms of the early 1990s.

¶11. The 1993 Constitution guarantees free convertibility of currency. There is, however, a legal limit on the amount that private pension fund managers can invest in foreign securities. In May 2004, the Central Bank increased this limit from 9 percent to 10.5 percent. The low limit has created local market distortions, trapping liquidity in Peru that is diverted into local equities and bonds, driving up their prices to artificially high levels.

¶12. The Central Reserve Bank of Peru is an independent institution, free to manage monetary policy to maintain financial stability. The Central Bank's primary goal is to maintain price stability, via a targeted rate of inflation During most of 2005 (January through end-August), the Peruvian Sol trended slightly down towards 3.25 to the dollar, as the Central Bank supported the dollar amid ballooning exports and emigrants' remittances. At the end

of August 2005, the U.S. Federal Reserve began to increase its federal fund rate from 1 percent to 3 percent, matching the Peruvian Central Bank's interest rate. When the U.S. federal interest rate increased to more than 3 percent in October, it became more profitable for institutional investors to buy dollars and deposit them abroad, accounting the appreciation of the dollar versus the sol. This trend continues, as the U.S. federal fund rate is now at 4.25 percent through December 2005. Additionally, the start of the Peruvian electoral campaign cycle in October 2005 and the uncertainly surrounding the upcoming Presidential elections have caused investors to hedge their bets and purchase additional dollars.

Expropriation and Compensation

¶13. According to the Constitution, the Peruvian government can only expropriate private property on public interest grounds (such as for public works projects) or for national security. Any expropriation requires the Congress to pass a specific act. The Government of Peru has expressed its intention to comply with international standards concerning expropriations. Adequate payment to owners of agricultural lands expropriated by the Peruvian government in the late 1960s/early 1970s is still an issue.

Dispute Settlement

¶14. Dispute settlement continues to be problematic in Peru, although the GOP has taken steps in 2005 to improve the dispute settlement process. In December 2004, with assistance from USAID, the GOP established eight commercial courts (seven courts of first instance or juzgados and one appeals court or sala to rule on investment disputes. These courts officially began functioning in April 2005. The GOP established five additional juzgados in October 2005, and another ten, plus an additional appeals court, will begin operations in Lima by May 2006. The commercial courts have substantially improved the process for commercial disputes. Prior to the existence of the commercial courts, it took an average of two years to resolve a commercial case through the civil court system. These new courts, which have specialized judges, have reduced the amount of time to resolve one case to two months, a reduction of 90 percent. Additionally, the enforcement of court decisions has been reduced from 36 months to 3-6 months. While about 40 percent of decisions are appealed, most of these are decided at the appeals level; very few are appealed to the Supreme Court level. The GOP will continue to train judges on commercial law and expects this rate of resolution and enforcement to be maintained. While these courts currently only operate in Lima, the GOP has plans to expand into other areas of Peru beginning in 2006. The Judiciary has approved the opening of two regional courts, one in Arequipa and one in Huancayo. There are also plans to open courts in Callao and the northern district of Lima, pending Judiciary approval.

¶15. The criminal and civil courts of first instance and appeal are located in the provinces and in Lima. The Supreme Court is located in Lima. In principle, secured interests in property, both chattel and real, are recognized. However, the judicial system is often extremely slow to hear cases and to issue decisions. In addition, court rulings and the degree of enforcement have been difficult to predict. The capabilities of individual judges vary substantially, and allegations of corruption and outside interference in the judicial system are common. The Peruvian appeals process also tends to delay final decisions. As a result, foreign investors, among others, have found that contracts are often difficult to enforce in Peru. The exposure in 2000 of a network of corrupt judges controlled by Fujimori advisor Vladimiro Montesinos led to promises by subsequent governments to address corruption and reform the judiciary, but progress has been slow.

¶16. Under the 1997 Law of Conciliation (DL 26872), which went into effect on January 1, 2000, disputants in many types of civil and commercial matters are required to consider conciliation before a judge can accept a dispute to be litigated. Private parties often stipulate arbitration to resolve business disputes, as a way to avoid involvement in judicial processes.

¶17. Peru's commercial and bankruptcy laws have proven difficult to enforce through the courts. The Toledo government established an administrative bankruptcy procedure under INDECOPI (the National Institute for the Defense of Free Competition and the Protection of Intellectual Property) to facilitate the process. This is now under review, since, in practice, the administrative bankruptcy process has proven to be slow, often dragging on for years at a time, and subject to judicial intervention. The creditor hierarchy is similar to that established under U.S. bankruptcy law, and monetary judgments are usually made in the currency stipulated in the contract.

¶18. A law permitting international arbitration of disputes between foreign investors and the government or state-controlled firms was promulgated in December 1992. The same

proviso was later included in the 1993 Constitution. As a result, the Government of Peru accepts binding international arbitration of investment disputes in accordance with national legislation or international treaties to which it is a party. Although Peru theoretically accepts binding arbitration, on a few occasions over the past three years, one involving a U.S. company, parastatal companies and Government Ministries disregarded unfavorable judgments. Previously, the Government of Peru turned these arbitration cases over to the judiciary, where they were bureaucratically delayed until the companies conceded the cases. However, effective July 2005, the Supreme Court ruled that all arbitration findings and awards are final and not subject to appeal. In December 2005, the U.S. company received payment of a previously disputed arbitral award of $1.9 million.

¶19. Peru is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention of 1958), and to the International Center for the Settlement of Investment Disputes (the Washington Convention of 1965). Disputes between foreign investors and the Government of Peru regarding pre-existing contracts must still be submitted to national courts. However, investors who conclude a juridical stability agreement for additional investments may submit disputes with the government to national or international arbitration if stipulated in the agreement. In 2005, the government resolved a high-level ATPDEA dispute by abiding by the decision of an arbitration panel in favor of foreign investors.

¶20. Several private organizations, including the Universidad Catolica and the Lima Chamber of Commerce, operate private arbitration centers. The quality of these centers varies, however, and investors should choose a venue for arbitration carefully. In one 2001 case involving the Lima Chamber of Commerce's arbitration center, a U.S. investor discovered irregularities in the way the case had been handled by the center.

¶21. The Peruvian government committed to resolve nine commercial disputes as a condition of the U.S granting trade benefits under the Andean Trade Promotion and Drug Eradication Act (ATPDEA) in 2002. In April 2004, the Peruvian government provided USTR with "roadmaps" for the resolution of several of these investment disputes. As of December 2005, three ATPDEA commercial disputes remain.

¶22. In December 2005, Peru and the United States concluded negotiations on a free trade agreement. Once signed and ratified, the agreement is expected to come into force in January 2007. The agreement includes a chapter on dispute settlement and, upon implementation, should further clarify the resolution process in Peru.

Performance Requirements and Incentives

¶23. Peru offers both foreign and national investors legal and tax stability agreements to stimulate private investment. These agreements guarantee that the statutes on income taxes, remittances, export promotion regimes (such as drawback), administrative procedures, and labor hiring regimes in effect at the time of the investment contract will remain unchanged for that investment for 10 years. To qualify, an investment must exceed $10 million in the mining and hydrocarbons sectors or $5 million in other sectors within two years. An agreement to acquire more than 50 percent of a company's shares in the privatization process may also qualify an investor for a juridical stability agreement, provided that the infusion will expand the installed capacity of the company or enhance its technological development.

¶24. There are no performance requirements that apply exclusively to foreign investors. Legal stability agreements are subject to Peruvian civil law, which means they cannot be altered unilaterally by the government. Investors are also offered protection from liability for acquiring state-owned enterprises.

¶25. Laws specific to the petroleum and mining sectors also provide assurances to investors. However, in 2000, the government modified the General Mining Law, substantially reducing benefits to investors in that sector. Among the changes were: a reduction in the term concessionaires are granted to achieve the minimum annual production; an increase in fees for holding non-productive concessions; an increase in fines for not achieving minimum production within the allotted time; a reduction in the maximum allowable annual accelerated depreciation; and revocation of the income tax exemption for reinvested profits. The changes do not affect those investors who have signed legal stability agreements with the government.

¶26. Parties may freely negotiate contractual conditions related to licensing arrangements and other aspects of technology transfer without prior authorization. Registry of a technology transfer agreement is required for a payment of royalties to be counted against taxes. Such registration is automatic upon submission to ProInversion.

¶27. Current law limits foreign employees to no more than 20 percent of the total number of employees in a local company (whether owned by foreign or national interests), and restricts their combined salaries to no more than 30 percent of the total company payroll. However, DL 689 (November 1991) provides a variety of exceptions to these limits. For example, a foreigner is not counted against a company's total if he or she holds an immigrant visa, has a certain amount invested in the company (currently about $4,000) or is a national of a country that has a reciprocal labor or dual nationality agreement with Peru. Foreign banks and service companies, and international transportation companies are also exempt from these hiring limits, as are all firms located in free trade zones. Furthermore, companies may apply for exemption from the limitations for managerial or technical personnel.

Right to Private Ownership and Establishment

¶28. Foreign and domestic entities are generally permitted the right to establish and own business enterprises and to engage in most forms of remunerative activity. Subject to the restrictions listed earlier in this document, both foreign and domestic entities may invest in any legal economic activity -- including foreign direct investment, portfolio investment, and investment in real property. Private entities may generally freely establish, acquire, and dispose of interests in business enterprises. In the case of some privatized companies deemed important by the government, privatization agency ProInversion has included a so-called "golden share" clause in the sales contract, which allows the government to veto a potential future purchaser of the privatized assets.

Protection of Property Rights

¶29. As noted in the Dispute Settlement section, in principle, secured interests in property (both chattel and real) are recognized. However, the Peruvian judicial system is often very slow to hear cases and to issue decisions, outcomes have been difficult to predict and enforce, and corruption is frequently alleged. The Peruvian appeals process also delays final outcomes of cases. Thus, foreign investors, among others, have found that contracts are often difficult to enforce in Peru. Improving the judicial system is one of President Toledo's top stated priorities.

¶30. Peru belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention, Bern Convention, Rome Convention, Phonograms Convention, Satellites Convention, Universal Copyright Convention, the World Copyright Treaty, the World Performances and Phonographs Treaty and the Film Register Treaty. After two years on the United States government's "Priority Watch List" under the Special 301 provisions of the 1988 Trade Act, Peru was lowered to the "Watch List" in 2001 following steps on the part of the Government of Peru to address intellectual property rights (IPR) piracy. Peru remains on the Watch List due to concerns about continued high rates of copyright piracy and inadequate enforcement of IPR laws, particularly with respect to the relatively weak penalties that have been imposed on IPR violators. Although the Peruvian Government in July 2004 increased the minimum penalty for piracy to four-year's imprisonment, there have yet to be any convictions under the new law. Other factors contributing to continued placement on the "Watch List" include Peru's lack of second-use patent protection for pharmaceuticals and a lack of protection for confidential test data that is submitted for the marketing approval of pharmaceutical and agrochemical products.

¶31. Peru's 1996 Industrial Property Rights Law provides an effective term of protection for patents and prohibits devices that decode encrypted satellite signals, along with other improvements. Peruvian law does not provide for pipeline protection for patents or protection from parallel imports. Although Peruvian law provides for effective trademark protection, counterfeiting of trademarks and imports of pirated merchandise are widespread.

¶32. Peru's Copyright Law is generally consistent with the TRIPS Agreement. However, textbooks, books on technical subjects, audiocassettes, motion picture videos and software are widely pirated. While the government, in coordination with the private sector, has conducted numerous raids over the last few years on large-scale distributors and users of pirated goods and has increased other types of enforcement, piracy continues to be a significant problem for legitimate owners of copyrights in Peru.

Transparency of Regulatory System

¶33. The transparency and independence of regulatory processes have become central issues for foreign investors in Peru. Many of the central government entities with which foreign firms must deal -- including the entities that maintain the company registry and supervise securities and exchanges (CONASEV), handle privatization and investment

issues (ProInversion), and handle competition policy and intellectual property matters (INDECOPI) -- have procedures that are relatively transparent and predictable. However, several foreign pharmaceutical companies, as well as the motion picture and music industry, continue to face increasing levels of piracy of their products, highlighting that INDECOPI, SUNAT and the Peruvian National Police are not effectively protecting and upholding patents. Banks, insurance companies and private pension funds are regulated primarily by the Superintendency of Banking and Insurance (SBS), which is charged with determining the qualifications of potential market entrants, and regulating firms once they have begun operations. SBS regulations are also seen as being transparent.

¶34. When the GOP privatized state-owned monopolies in the areas of telecommunications, electrical generation and distribution, and the hydrocarbons sector in the late 1990s, the GOP established regulatory institutions to oversee the newly private sectors. Several of these regulatory institutions, including telecommunications regulator OSIPTEL and energy sector regulator OSINERG, are inexperienced and slow. The delays and lack of predictability in their rulings have in some cases been notable impediments to doing business in Peru.

¶35. In 2004-2005, two U.S. companies faced competitive disadvantages over OSIPTEL's very slow process for seeking regulation of the excessively high mobile termination rates of the market leader. In December 2005, however, OSIPTEL published a new law that makes Peru's high mobile termination rates comparable to international rates over a three-year period. Two U.S. companies have encountered problems with the energy sector regulator (OSINERG) over its hesitancy to provide clear regulation for the energy sector. Some agencies, including the tax authority (SUNAT), OSIPTEL, the General Directorate for Civil Aviation (DGAC) and the transportation regulator (OSITRAN), have been subject to politically motivated government intervention in their technical operations. In 2005, a small U.S. company, funded by an OPIC guarantee, was forced out of business due to unfair competition when the DGAC authorized the Peruvian Air Force to fly cheaper priced civic flights.

¶36. The Toledo government replaced the heads of all regulatory agencies, but improvements in transparency have been uneven.

¶37. U.S. firms have complained that the autonomous tax authority's (SUNAT) aggressive behavior and interpretation of law are often contrary to the spirit of the law and intent of government policies, complicating normal business operations. The remuneration of SUNAT employees is determined, in part, by the theoretical tax liability they uncover in audits. While the U.S. Embassy has not received complaints that SUNAT employees are soliciting bribes for lower tax assessments, this incentive system has sometimes produced convoluted and unpredictable interpretations of the tax law.

¶38. Businesses point out that SUNAT's retroactive reinterpretation of regulations and laws, its levying of disproportionate fines, and initiation of full company audits when companies request a refund or legal revaluation of assets for depreciation purposes, create additional investment and trade barriers. In one case, a U.S. firm unwittingly requested an improper drawback of $1,345, only to face SUNAT fines of $645,000. Although the case was resolved, new legislation was needed to correct the problem. In instances involving airline fuels, certain minerals, and other products, SUNAT declared that these goods sold abroad, which under Peruvian government policy are exempted from taxes, were not considered exports and were therefore subject to VAT. Two recent laws were necessary to correct this practice for airline fuels and services. SUNAT often does not follow standard international practice in the way it taxes new activities. To correct these problems, the independent tax tribunals act to check any abuses by SUNAT. In 2004, the GOP established a tax ombudsman who must approve SUNAT's request to appeal adverse tax tribunal decisions. In the past two years, the tax ombudsman has acted in several cases to end unwarranted litigation of disputed assessments. In 2005, a U.S. company won long-standing tax cases against SUNAT as a result of these improvements.

¶39. A 2004 World Bank study found that starting a business takes an average of 98 days in Peru, among the longest in the Western Hemisphere. Various procedures -- such as obtaining building licenses or certificates of occupancy -- require many steps. Municipal authorities issue most licenses and requirements vary widely by locality. As a result, information on necessary procedures is often difficult to obtain. Business people often complain of excessive red tape; one major foreign investor found that starting project construction and a business required several hundred permits, many of which the responsible government entities were unaware they had to issue. Other investors argue that local governments and municipalities, which are seeking new revenue sources, sometimes withhold licenses or create regulations, thus hindering the ability to do business or making it costlier. Even though import

tariffs are substantially lower than previously, import duties (the simple average tariff is a 10.1 percent ad valorem plus surcharge as of November 2005; the 2004 trade-weighted average is 9.4 percent), together with the 19 percent value added tax on goods, high social security tax rates, and certain labor laws increase investment costs significantly and hinder the efficient mobilization and allocation of investment capital. Although businesses can apply for VAT reimbursement, they often do not; when a company applies for reimbursement, the SUNAT conducts a full company audit.

Efficient Capital Markets and Portfolio Investment
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¶40. Credit is allocated on market terms and the banking industry in Peru is generally considered to be competitive in offering services to business customers. Foreign investors can obtain credit on the local market and several of them have done so in the last few years as terms were more competitive than those of the usual international centers. The private sector has access to a variety of credit instruments. In the year through early-December 2005, firms placed $1.2 billion on the local bond market (compared with $1.2 billion in calendar 2004), which has been propelled in recent years by demand for investment instruments by private pension fund companies. By October 2005, pension funds managed a total of $9.37 billion, a 24% surge over the October 2004 level ($7.54 billion), thus creating a big and growing appetite for financial instruments by pension funds. The 10.5% cap placed by the central bank on what the pension funds can invest abroad, means that local bond issuers (including the government) and loan seekers have a captive capital market for them.

¶41. All firms listed on the Lima Stock Exchange (Bolsa de Valores de Lima) or the Public Registry of Securities must be vetted by CONASEV, the National Commission for the Supervision of Companies, Securities and Exchanges, which maintains the Public Registry of Securities and Stock Brokers. CONASEV is the Peruvian government entity charged with the study, promotion, and regulation of the securities and commodities markets, the control of market participants, the maintenance of a transparent and orderly market, the setting of accounting standards and the publication of financial information about covered companies. As part of CONASEV's goal to promote market transparency, to prevent monopolies, and to prevent fraud, issuers of stock are required to inform CONASEV and the relevant stock exchange or body in charge of supervising the centralized trading mechanism, of events that affect or might affect the stock, the company, or any public offerings. Although trading on insider information is technically a crime, no one has been punished under the law.

¶42. Total assets of the commercial banks were $20.7 billion at the end of October 2005, 10% above the same period of ¶2004. The banking system is considered generally sound, as it weathered rather well a severe El Nino and global financial turmoil in 1997-98. Sound supervision combined with competition, led to a significant consolidation in the sector, which still continues. Consequently, 14 commercial banks remain in the system, of which three banks account for over two-thirds of loans and three-fourths of deposits. This number will shrink to 13 once the early-December 2005 purchase of the third largest local bank by a large Canadian bank is completed, as it will be merged with a small local bank. Banks have revamped operations, increased capitalization, and reduced costs in recent years. As of November 2005, foreigners were majority owners of nine and had shares in twelve commercial banks. Under the SBS's conservative criteria, 2.6 percent of total loans were assessed as non-performing as of October 2005, down from a high of 11 percent in early 2001. The system also has three specialized institutions ("financieras") and about 40 thriving micro-lenders and savings banks.

¶43. Larger private firms often use "cross-shareholding" and "stable shareholder" arrangements to restrict investment by outsiders -- not necessarily foreigners -- in their firms. As close family or associates generally control ownership of Peruvian corporations, hostile takeovers are practically non-existent. Peruvian law and regulations do not authorize or encourage private firms to adopt articles of incorporation or association to limit or restrict foreign participation; neither are there any private or public sector efforts to restrict foreign participation in industry standards-setting organizations.

¶44. Foreign direct investment registered with ProInversion as of November 2005 was $12.7 billion, compared with $12.9 billion a year earlier. Foreign portfolio investment totaled $3.7 billion through September 2005, up from $3.0 billion a year earlier.

Political Violence

¶45. Although political violence against investors is not a common practice, the mining community witnessed an increase in protests, some violent, in 2005. Violent invasions of mining exploration and excavation sites occurred more than a

dozen times at more than seven sites in 2005, causing several foreign companies to significantly delay or to abandon plans to establish operations. Protests against the mining industry occurred for various reasons, including environmental and social concerns. Often times, well-organized groups, such as the Ronderos, will exaggerate a local community's concerns, bringing in protestors from all areas to foment violence against the mines. In at least one instance in 2005, the local mayor led a strike against a large foreign mining company in an effort to extort additional funds from the company. During 2005, there were road blockages and acts of vandalism by groups protesting mining operations, coca growers protesting the Government's eradication policies, and farmers seeking increased government tariff protections and financial support. There were also river blockages by some native communities seeking a share of the oil and gas royalties.

¶46. Political violence remains a concern in the coca-growing regions. The Sendero Luminoso (SL) terrorist organization has become increasingly aggressive in these areas, carrying out three deadly ambushes of police and military personnel in 2005, including a December 5 attack in Ayacucho that killed five policemen and wounded a policeman and a prosecutor. There is no illicit foreign investment and little government presence in the remote coca-growing zones of the Monzon and the Apurimac-Ene River (VRAE) valleys. The U.S. Embassy in Lima restricts visits by official personnel to these areas because of the threat of violence by narcotics traffickers and remaining columns of the SL terrorist group. Information about insecure areas and recommended personal security practices can be found at http://www.ds-osac.org/.

¶47. On January 1-4, 2005, approximately 160 members of the ultra-nationalist Ethno-Cacerista Movement seized a police station, took hostages, and killed four policemen, before surrendering to the authorities. The brother of the leader of this uprising is now one of the leading candidates for the Presidency.

Corruption

¶48. It is illegal in Peru for a public official or employee to accept any type of outside remuneration for the performance of his or her official duties. Peru has ratified both the UN Convention Against Corruption and the Organization of American States' Inter-American Convention Against Corruption. Peru is not a member of the Organization of Economic Cooperation and Development, and has not signed the OECD Convention on Combating Bribery.
¶49. Peru is one of four nations worldwide participating as a pilot country in the G8 anti-corruption and transparency initiative. The U.S. has worked vigorously to help the Peruvian government prepare a detailed action plan, in coordination with other G8 partners and NGOs, of activities it will pursue under the initiative. The plan envisions activities in six areas: a) citizen information/internet connectivity; b) improving central government fiscal transparency; c) development of GOP procurement systems; d) improving regional/local government transparency and management; e) improvement of transparency of extractive industry revenues; and f) development of asset forfeiture systems and legislation. Total project expenditure under the initiative is expected to be $40 million in 2005-06, with the U.S. already funding some projects.

¶50. U.S. firms have reported only a small number of problems directly resulting from corruption, usually in government procurement processes and in the judicial sector, but the revelation in late 2000 of a broad and deep corruption ring organized by former presidential advisor Vladimiro Montesinos has heightened awareness of the problem. Transparency International ranked Peru number 74 (out of 145 countries) in its 2004 Corruption Perception Index. (In the same study, Chile was ranked 20, Brazil was number 59, Colombia was ranked 60 and Argentina was ranked 108.) While anti-corruption efforts have been a stated priority of the Toledo Government, in practice most resources are directed at investigating Fujimori-era corruption. In 2001, President Toledo appointed an anti-corruption "czar" to lead government efforts, but this official resigned in 2002 and has yet to be replaced. Private sector groups have increased efforts to combat corruption through an NGO called "ProEtica," which represents Transparency International in Peru.

Bilateral Investment Agreements

¶51. Peru has signed bilateral investment agreements with 29 countries (listed below). In December 2005, the United States and Peru finalized negotiations for a bilateral trade agreement, eliminating the need for a bilateral investment agreement. The agreement has yet to be approved and ratified by both the U.S. and Peruvian Congresses but is scheduled to go into effect on January 1, 2007, to prevent any lapse in preferential benefits. Peru is currently the 43rd largest export market for U.S. goods, with U.S. exports exceeding over $1.7 billion through October 2005. U.S. foreign direct investment in Peru totaled $3.9 billion

through December 2004. The U.S.-Peru Trade Promotion Agreement (TPA) extends the list of countries in the Western Hemisphere with which the United States has completed such agreements and would complement the goal of completing Free Trade Area of the Americas (FTAA) negotiations.

Peru's Current Bilateral Investment Agreements

Argentina (1994)	El Salvador (1997)	Portugal (1994)
Australia (1995)	Finland (1995)	Rumania (1994)
Bolivia (1993)	France (1993)	Singapore (2003)
Chile (2000)	Germany (1995)	Spain (1994)
China (1994)	Italy (1994)	Sweden (1994)
Colombia (1994)	Korea (1993)	Switzerland (1991)
Cuba (2000)	Malaysia (1995)	Thailand (1991)
Czech Rep (1994)	Netherlands (1994)	United Kingdom (1993)
Denmark (1994)	Norway (1995)	Venezuela (1996)
Ecuador (1999)	Paraguay (1994)	

OPIC and Other Investment Insurance Programs

¶52. The Overseas Private Investment Corporation (OPIC), an independent U.S. Government agency, offers medium- to long-term financing and political risk insurance. OPIC signed agreements with Peru in December 1992, and in July 1994, OPIC began approving requests for political risk insurance (including for inconvertibility of currency). In 2001, OPIC provided project finance loans of $108.4 million. In 2005, OPIC provided $800 million worth of insurance coverage for a copper mine. A startup finance company received $27 million worth of OPIC insurance coverage. Because of the free convertibility of currency, the U.S. Embassy purchases Peruvian currency for expenses on an as-needed basis, at the market exchange rate. The risk of significant depreciation of the exchange rate over the next year is negligible. Peru is a member of the Multilateral Investment Guarantee Agency.

Labor

¶53. Labor is abundant and trainable, although there are shortages of highly skilled workers in some fields and wages for professional staff are high (sometimes higher than U.S. wages in the mining sector for positions in the managerial and consulting fields). The presence of organized labor in the Peruvian economy has declined; it is estimated that less than five percent of the labor force is organized. Unemployment in Lima officially stood at 7.9 percent in October 2005, compared with 9.2 the previous year; surveys show that about 55 percent of the economically active population was underemployed, mostly working in the informal sector for below subsistence wages. As of August 2005, the statutory monthly minimum wage was $141 (460 soles). Most workers in the formal sector receive more than the minimum wage, as well as additional non-wage benefits.

¶54. In 1991-1992, a new labor law and other related statutes replaced a greater number of old statutes and regulations. The new laws allow for multiple forms of unions across company or occupational lines, thus permitting multiple unions in the same company. Workers in probation status or on short-term contracts are not eligible for union membership. Bargaining agreements are considered contractual agreements, valid only for the life of the contract. Productivity provisions must be included in any collective bargaining agreement. The number of officialsand the amount of time union officials may devote to union work with pay is limited to 30 days per year. Unless there is a pre-existing labor contract covering an occupation or industry as a whole, unions must negotiate with each company individually. A labor law passed in July 1995 liberalized hiring.

¶55. Business leaders lauded the above changes, saying they led to greater efficiency. Labor leaders disagreed, arguing that the new labor laws eroded labor protections and encouraged outsourcing in a way that undercut union activity. With Peru's return to democracy in 2000, Peruvian organized labor regained some, but by no means all, of the protections enjoyed in the pre-Fujimori era. A decision by the Constitutional Tribunal in 2004, for example, legitimized collective industry-wide bargaining in the civil construction industry. Labor leaders saw this as a potential precedent to be applied to other activities. That has not yet happened, however.

¶56. Either unions or management can request binding arbitration in contract negotiations. Strikes can be called only after approval by a majority of all workers (union and non-union) voting by secret ballot and only in defense of labor rights. Unions in essential public services, as determined by the government, must provide a sufficient number of workers, as determined by the employer, during a strike to maintain operations.

¶57. The 1993 Constitution provides for a maximum workday of eight hours, with 48 hours as the maximum week. The labor code also sets 24 hours rest per week and 30 days paid annual vacation for all workers. Workers readily sacrifice

these and other benefits in exchange for regular employment. Strike activity declined markedly over the past nine years and since new labor laws were passed, worker efficiency rose substantially. However, strikes and militant industrial action increased again in late 2002 and early 2003, with additional strikes in 2004. The overall number of strikes fell in 2005. Through October 2005, there were 58 strikes with a loss of 442,586 man-hours, compared with 91 strikes and a loss of 515,480 man-hours in the same period of 2004. Congress continues to debate a comprehensive labor law reform, but the law remains delayed over the conditions of dismissal for employees.

Foreign Trade Zones/Free Ports

¶58. Current Peruvian law governs the two types of free trade zones: export, transformation, industry, trade and services zones (CETICOS), and a free trade zone (ZOFRATACNA) in Tacna. The rules and tax benefits applying to these zones are the same for foreign and national investors.

¶59. Companies established at the CETICOS and ZOFRATACNA, which export no less than 92 percent of their output (more than 80 percent of production for the Loreto CETICOS and more than 50 percent for ZOFRATACNA), are exempted until 2012 from all taxes, dues and contributions from the central government and municipalities, particularly income, sales (IGV), Municipal Promotion (IPM) and excise (ISC) taxes. CETICOS exist at Ilo, Matarani and Paita, with one authorized but not operating at Loreto. There is a concern that the Peruvian Government does not have the proper WTO waivers to validate the CETICOS export requirement. The U.S. automotive industry has expressed a specific concern that U.S. brands are unable to compete with used Japanese vehicles that enter the Peruvian market duty-free through the CETICOS. Importers locating in ZOFRATACNA pay only eight percent customs duties (normal rates are 12 or 20 percent) on 1,086 items sold to retailers in the city of Tacna.

Foreign Direct Investment Statistics

¶60. The stock of registered foreign direct investment in Peru was $12.7 billion by November 2005, according to ProInversion, versus $12.9 billion at the end of 2004. ProInversion data place Spanish investors as holding the largest share (25 percent), with $3.2 billion invested. The United Kingdom is the second largest investor, with $2.8 billion, and the United States is third, with $2.0 billion. However, calculated on a replacement-cost basis, the U.S. is by far the largest source of foreign direct investment in Peru. According to the U.S. Department of Commerce, U.S. registered investment in Peru through December 2004 totaled $3.9 billion. The statistics are skewed because ProInversion records investments on the basis of country registry, rather than control. Thus, an investor registered in the Bahamas, for example, is recorded as British even if the parent is a U.S. company. As a result, U.S.-controlled investment represents a much higher share than the official 15.7 percent. By sector, communications received 29 percent of foreign direct investment in 2005, followed by finance (17.4 percent), manufacturing industry (14.8 percent), mining (13.6 percent), and electricity (12.9 percent).
¶61. As of November 2005, investors had signed 413 legal stability contracts with the Government of Peru. Legal stability contracts commit the government not to apply any future changes in the income tax, labor and other laws governing a specific investment in exchange for commitments to invest a given amount.

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